

Report
of the
Examination of
Alpha Property & Casualty Insurance Company
Dallas, Texas
As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Commissioners:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

ALPHA PROPERTY & CASUALTY INSURANCE COMPANY
Dallas, Texas

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of Alpha Property & Casualty Insurance Company
("Alpha P&C," the "company") was conducted in 1997 as of December 31, 1996. The current
examination covered the intervening period ending December 31, 2001, and included a review of
such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's
operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

Alpha Property & Casualty Insurance Company was organized in 1979 as a Wisconsin domiciled insurer licensed under Chapter 611 of the Wisconsin Statutes. The company was initially established as a subsidiary of Family Insurance Corporation ("Family"), a Wisconsin domiciled life and health insurer. The principal shareholder of Family was Wisconsin Finance Corporation ("WFC"), a financial holding company. In 1985, WFC was purchased by United Savings of America ("United Savings"), subsequently merged into Heights Finance, and changed its name to USA Financial Services. Alpha P&C was dividdened by Family to USA Financial Services in 1991 to facilitate the sale of Family to a third party.

The United Savings enterprise subsequently became financially impaired during the 1990's savings and loan financial distress, and United Savings and its subsidiaries including Alpha P&C were placed under the supervision of the Resolution Trust Corporation (the "Trust"). Milwaukee Insurance Group, Inc. ("MIG") acquired all of the outstanding shares of Alpha P&C capital stock from the Trust on December 31, 1992.

Milwaukee Insurance Group, Inc. was established in 1985 as a wholly owned subsidiary of Milwaukee Insurance Company ("MIC," formerly known as Milwaukee Mutual Insurance Company, a Wisconsin domiciled property and casualty insurer), and served as an intermediate holding company for Milwaukee Insurance Company's stock insurance company subsidiaries. In November 1986, MIG issued additional shares of its common capital stock and conducted an initial public stock offering. Upon completion of the offering, approximately 65% of the common stock of MIG remained under the ownership of Milwaukee Mutual, and the remaining 35% was owned by public shareholders. MIG conducted a second public offering of 1,000,000 newly issued shares of MIG common stock in 1993, resulting in the reduction of Milwaukee Mutual's ownership interest of MIG to approximately 49%.

Trinity Universal Insurance Company ("Trinity Universal") acquired all of the capital stock of Milwaukee Insurance Group, Inc. effective October 2, 1995. Trinity Universal is a Texas domiciled property and casualty insurer wholly owned by Unitrin, Inc. Upon the change of control of MIG to Trinity Universal, the ultimate ownership and control of the former Milwaukee Insurance

Company subsidiaries Milwaukee Casualty Insurance Co. ("Milwaukee Casualty"), Milwaukee Safeguard Insurance Company ("Milwaukee Safeguard"), and Alpha P&C transferred to Unitrin, Inc. MIG was dissolved in 2001 and its assets and liabilities were merged into Trinity Universal. Upon the dissolution of MIG, Alpha P&C became a directly held wholly owned subsidiary of Trinity Universal Insurance Company.

Alpha P&C does not have any employees, and all operating functions of the company are performed by affiliates within the Unitrin, Inc. holding company pursuant to numerous intercompany agreements. Trinity Universal and affiliates in the Unitrin, Inc. holding company conduct all of Alpha P&C's business operations, including insurance underwriting, marketing and policy issuance, claims administration and adjudication, investment management, and accounting and financial reporting. Business written by the company in nineteen states is administered by Financial Indemnity Company, a California domiciled property and casualty insurer, pursuant to agreements between the company and Trinity Universal. The business written by the company in Florida is produced through direct response marketing channels and is administered by the affiliate Unitrin Direct Insurance Company ("Unitrin Direct"), an Illinois domiciled insurer. In Georgia and Missouri the business written by the company is administered by Charter General Agency, Inc. ("Charter Agency"), a Texas domiciled third party administrator. Further discussion of the Unitrin, Inc. holding company organization, description of the significant insurance affiliates of the company, and description of the company's affiliated agreements is included in the section of this report captioned "Affiliated Companies."

In 2001 the company wrote direct premium in the following states:

Florida	\$14,574,851	24%
Illinois	7,487,873	12%
Missouri	6,643,126	11%
Ohio	6,200,842	10%
Georgia	5,364,440	9%
All others	<u>19,923,763</u>	<u>33%</u>
	<u>\$60,194,895</u>	<u>100%</u>

The company is licensed in 22 states, including the States of Arizona, Arkansas, Colorado, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kentucky, Minnesota, Missouri, Nebraska, Nevada, North Carolina, North Dakota, Ohio, South Carolina, South Dakota, Tennessee, Washington, and Wisconsin.

The major products marketed by the company include private passenger automobile liability, auto physical damage, and inland marine. Alpha P&C is an operating company in the Unitrin, Inc. Specialty Lines Insurance business group, and specializes in offering automobile and motorcycle insurance for risks that are classified as substandard. The company's insurance policies are marketed by various affiliates through the respective affiliates' regional operations offices and independent agents.

The following table is a summary of the net insurance premiums written by the company in 2001. The growth of the company is discussed in the Financial Data section of this report.

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Inland marine	\$997,589	\$0	\$933,230	\$64,359
Private passenger auto liability	37,387,906		34,556,075	2,831,831
Auto physical damage	21,663,093		20,148,856	1,514,237
Write-ins for other lines of business:				
Policy fee	<u>146,307</u>	<u>—</u>	<u>146,307</u>	<u>—</u>
Total All Lines	<u>\$60,194,895</u>	<u>\$0</u>	<u>\$55,784,468</u>	<u>\$4,410,427</u>

III. MANAGEMENT AND CONTROL

Board of Directors

The Alpha P&C board of directors consists of five members. Each director is elected annually by the company's sole shareholder to serve a one-year term of office. Each director of Alpha P&C is a senior executive officer of the parent holding company Unitrin, Inc., and also serves as a director on one or more boards of directors of other companies within the holding company. The board members receive no compensation for serving on the Alpha P&C board of directors.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
David F. Bengston Woodstock, IL	Vice President Unitrin, Inc.	2003
Eric J. Draut Arlington Heights, IL	Executive Vice President, Chief Financial Officer and Director—Unitrin, Inc.	2003
John W. Mullen McKinney, TX	President—Unitrin Specialty Lines Insurance	2003
Richard Roeske Naperville, IL	Vice President Unitrin, Inc.	2003
Donald G. Southwell Wayne, IL	President, Chief Operating Officer and Director Unitrin, Inc.	2003

Officers of the Company

The executive officers of the company are elected by the Alpha P&C board of directors at the board's annual meeting, and serve a one-year term of office. Each senior officer of the company also serves as a senior officer of other companies within the holding company organization. The company's senior executive officers serving at the time of this examination are as follows:

Name	Office	2001 Compensation
Donald G. Southwell	Chairman of the Board	\$10,136
John W. Mullen	President	66,305
Philip R. Lombardo	Vice President and Treasurer	24,981
Gregory L. Himebauch	Secretary	3,334
David J. Pearce	Vice President	11,034

Annual employment compensation of the company's officers is paid by affiliate companies in the holding company. Unitrin, Inc. and Trinity Universal annually establish separate expense budgets whereby a portion of various operating expenses including officer compensation is allocated and charged to subsidiary operating companies. The compensation data reported above is the amount of the annual employment compensation paid to the company's officers that was charged to the company in 2001 through the annual budgetary allocation process.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee

Donald G. Southwell
Eric J. Draut
John W. Mullen

Investment Committee

Donald G. Southwell
Eric J. Draut
John W. Mullen

In addition to the two committees of the Alpha P&C board of directors, the board also appoints an audit committee, as required by one state jurisdiction in which the company maintains license authority. The company's holding company parent, Unitrin, Inc., performs audit committee oversight functions for all of its subsidiary companies including Alpha P&C, and the executives who comprise the Unitrin, Inc. Audit Committee also comprise the Alpha P&C appointed Audit Committee. The Audit Committee of Unitrin, Inc. and Alpha P&C at the time of the examination is as follows:

Audit Committee

Ruben L Hedlund
William E. Johnson, Jr.
Douglas G. Geoga
Jerrold V. Jerome
Ann E. Ziegler

IV. AFFILIATED COMPANIES

Alpha Property & Casualty Insurance Company is a member of the Unitrin, Inc. holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of affiliates significant to the company follows the organizational chart.

Unitrin, Inc. Organization Chart

Unitrin, Inc.

- Fireside Securities Corporation
 - Fireside Thrift Co.
- Unitrin Services Company
- Unitrin Direct Insurance Company
 - Unitrin Advantage Insurance Company
- Trinity Universal Insurance Company
 - Alpha Property & Casualty Insurance Company
 - Milwaukee Casualty Insurance Co.
 - Milwaukee Safeguard Insurance Company
 - Financial Indemnity Company
 - Security National Insurance Company
 - Southern States General Agency, Inc.
 - Southern States Finance Corporation
 - Trinity Lloyd's Corporation
 - Trinity Lloyd's Insurance Company
 - Trinity Universal Insurance Company of Kansas, Inc.
 - Valley Group, Inc.
 - Charter Group, Inc.
 - Charter General Agency, Inc.
 - Charter Indemnity Company
 - NCM Management Corporation
 - Valley Property & Casualty Insurance Company
 - Valley Pacific, Inc.
 - Valley Insurance Company
- Kemper Auto & Home Group, Inc.
 - Kemper Enterprise Agency, Inc.
 - Kemper Auto & Home Insurance Company
 - Unitrin Direct General Agency, Inc.
 - Kemper Independence Insurance Company
- United Insurance Company of America
 - NationalCare Insurance Company
 - Reserve National Insurance Company
 - Summerset Marketing Company
 - National Association of Self-Employed Business Owners
 - Rural American Consumers A National Association
 - The National Association of Medicare Members, Inc
- The Reliable Life Insurance Company
 - Clayton Reinsurance, LTD.
 - Clayton Reinsurance LTD (Bermuda)
 - Family Security Funerals Company
 - The Reliable Life Insurance Company of Texas
- Union National Life Insurance Company
 - Union National Fire Insurance Company
- United Casualty Insurance Company of America
- One East Wacker Corporation
- Unitrin Auto and Home Insurance Company
- Unitrin Preferred Insurance Company
- Unitrin Data Systems, Inc.
- Unitrin Internal Audit Services, Inc.

Unitrin, Inc.

Unitrin, Inc., is a publicly traded holding company incorporated in the State of Delaware in February 1990. Unitrin, Inc. was established to hold all of the insurance and finance business subsidiaries of Teledyne, Inc., which spun off all of its remaining insurance and finance subsidiaries on April 20, 1990 through the distribution to its shareholders of the outstanding capital stock of Unitrin, Inc. Through its operating subsidiaries, Unitrin, Inc. offers property and casualty insurance, life and health insurance, and consumer finance products and services. Operations of the Unitrin, Inc. holding company are organized into five strategic business segments: Multi Line Insurance, Specialty Lines Insurance, Unitrin Direct, Life and Health Insurance, and Consumer Finance.

As of December 31, 2001, Unitrin, Inc.'s GAAP basis audited financial statements reported total assets of \$7,133.7 million, total liabilities of \$5,216.9 million, and total shareholders' equity of \$1,916.8 million. Operations in 2001 provided reported net income of \$380.9 million.

Unitrin Services Company ("Unitrin Services")

Unitrin Services Company provides senior executive management, administrative services, and computer services to all of the operating companies within the Unitrin, Inc. holding company. Services provided include executive management; investment management, analysis and accounting; financial accounting and reporting; tax accounting and tax return preparation; internal audit; financial planning; capital project evaluation; real estate management; and computer equipment and processing services. The costs of services rendered by Unitrin Services are allocated to its respective affiliates pursuant to general services agreements and computer services agreements established between Unitrin Services and its affiliates.

As of December 31, 2001, Unitrin Services's GAAP basis unaudited financial statements reported total assets of \$26.7 million, total liabilities of \$43.7 million, and total shareholders' equity of \$(17) million. Operations in 2001 provided reported net loss of \$1.6 million.

Unitrin Direct Insurance Company ("Unitrin Direct")

Unitrin Direct Insurance Company is an Illinois domiciled property and casualty insurer. Unitrin Direct changed its name from Union Automobile Indemnity Company effective May 15, 2000. In 2000 Unitrin Direct ceded its existing book of business to affiliated companies and converted its operations to direct response insurance marketing. Unitrin Direct writes private passenger automobile insurance conducted by direct response marketing operations in various states. Unitrin Direct administers the direct marketing business of Alpha P&C in the State of Florida, and administers the direct marketing business of Milwaukee Casualty written in all states.

As of December 31, 2001, Unitrin Direct's statutory basis audited financial statements reported total admitted assets of \$19 million, total liabilities of \$1.9 million, and surplus as regards policyholders of \$17 million. Operations in 2001 provided reported net income of \$675 thousand.

Trinity Universal Insurance Company ("Trinity Universal")

Trinity Universal Insurance Company is a multi-line insurance company organized under the laws of Texas in 1932 from the merger of Trinity Fire Insurance Company and Universal Automobile Insurance Company. Trinity Universal is the largest property and casualty insurance subsidiary of Unitrin, Inc., and is the holding company's leading insurer in the Multi Line Insurance business segment. Trinity Universal and its subsidiary insurers operate primarily in the Southern, Midwestern, and Western states, and offer preferred risk and standard risk automobile, homeowners, fire, commercial liability, workers compensation, and related insurance products. Trinity Universal is the immediate parent of three Wisconsin domiciled insurers, including Milwaukee Casualty Insurance Co., Milwaukee Safeguard Insurance Company, and Alpha Property & Casualty Insurance Company.

As of December 31, 2001, Trinity Universal's statutory basis audited financial statements reported total admitted assets of \$1,955.5 million, total liabilities of \$1,324.2 million, and surplus as regards policyholders of \$631.2 million. Operations in 2001 provided reported net income of \$285.7 million.

Charter General Agency, Inc. ("Charter Agency")

Charter General Agency, Inc. is a Texas domiciled third party administrator of insurance business. The sole business of Charter Agency is administration of the specialty line business that is written on Alpha Property & Casualty Insurance Company in the states of Missouri and Georgia. Annual financial statements are not prepared for the Charter General Agency, Inc. legal entity.

Valley Insurance Company ("VIC")

Valley Insurance Company is a property and casualty insurance company subsidiary of Trinity Universal Insurance Company, domiciled in the State of California. VIC provides multi-line property and casualty individual and business insurance coverages, marketing its products in the western United States through independent agents.

As of December 31, 2001, VIC's statutory basis audited financial statements reported total admitted assets of \$32.5 million, total liabilities of \$13.7 million, and surplus as regards policyholders of \$18.8 million. Operations in 2001 provided reported net loss of \$1.4 million.

Affiliated Agreements

1. Federal Income Tax Allocation Agreement – In 1996 a federal income tax allocation agreement was established between Unitrin, Inc. and various of its affiliates, including Milwaukee Casualty, Milwaukee Safeguard, and Alpha P&C. The agreement provides the basis for the method of settlement of federal income tax payments and refunds within the Unitrin, Inc. group. Unitrin, Inc. files a consolidated federal income tax return that includes the tax filings for the Unitrin, Inc. affiliates. Estimated quarterly federal income tax payments are paid to the IRS by Unitrin, Inc., and additional settlement with the IRS is made in the following year. The respective affiliates pay to Unitrin, Inc. the amount of regular income tax, alternative minimum tax, and environmental tax that the affiliates would otherwise have paid to the IRS on a separate-company basis. Each affiliate's federal income tax liability or refund is limited to the separate company basis, and final settlement of federal income tax amounts due between Unitrin, Inc. and the affiliates are made within thirty days of the filing of the Unitrin, Inc. tax return or within thirty days of receipt of refund associated with the Unitrin, Inc. return. The tax allocation agreement applies to tax years on or after December 31, 1995.
2. 1997 General Service Agreements – Effective January 1, 1997, separate general service agreements were established between Unitrin Services Company and Milwaukee Insurance Company, Milwaukee Casualty, Milwaukee Safeguard, and Alpha P&C. Under the agreements, Unitrin Services provides various operations services, including executive management, investment trade execution and investment accounting, financial accounting and reporting, tax accounting, risk management, internal audit, cash management and bank relations, financial planning, and legal support services. A portion of Unitrin Services' costs incurred in providing the services is allocated to each of the insurers on the basis of the hourly salary and employee benefits costs of the Unitrin Services employees who perform the services.

In addition to the above agreements, an additional general service agreement was established effective January 1, 1997 between Milwaukee Insurance Company and Trinity Universal Insurance Company. The provisions of the agreement are identical to the Unitrin Services agreements described above except that the Trinity Universal agreement does not provide for investment trade execution and analysis, tax accounting or advice, or corporate secretarial services. Allocation of Trinity Universal incurred costs is based on the hourly salary and employment benefit costs of the Trinity Universal employees who provide the services, as well as all out-of-pocket expenses incurred by Trinity Universal. The general services agreements have a continuous term unless terminated by the respective parties upon not less than 30 days prior written notice.

3. 1997 Computer Services Agreements - Effective January 1, 1997, separate computer service agreements were established between Unitrin Services Company and Milwaukee Insurance Company, Milwaukee Casualty, Milwaukee Safeguard, and Alpha P&C. Under the agreements, Unitrin Services provides various computer processing and equipment services, including processing using Unitrin, Inc. systems at any of its data center facilities, and the use of systems including central processors and controllers, data storage devices and drives, data management software, network software, and other facilities. Unitrin Services's projected annual costs are allocated proportionately to the respective insurers based on projected usage by monthly invoices. At year-end Unitrin Services reconciles its budgeted costs and the insurer's projected usage with actual costs and usage, and the parties execute net settlement for the year ending. The computer services agreements have a continuous term unless terminated by the respective parties upon not less than 30 days prior written notice.
4. 1999 Services Agreement – A services agreement between Alpha Property & Casualty Insurance Company and Charter General Agency, Inc. was transacted effective July 22, 1999. Pursuant to the agreement, Alpha P&C appointed Charter Agency to manage and

service Alpha P&C's private passenger automobile insurance written in the States of Missouri and Georgia. Charter exercises comprehensive authority to administer all aspects of the subject business, including policy underwriting; marketing operations; policy administration; premium billing and collection; loss reserve estimation; claim adjudication, settlement and payment; and maintenance of books, accounts, and records. Either party may terminate the agreement without cause at any time by providing not less than 90 days advance written notice.

5. 2001 General Services Agreement – Effective April 1, 2001, a general services agreement was established between Alpha Property & Casualty Insurance Company and Unitrin Direct Insurance Company. The agreement provides that Unitrin Direct will administer all aspects of the direct-marketing private passenger automobile business of Alpha P&C written in the State of Florida. Unitrin Direct exercises comprehensive authority to administer all aspects of the subject business, including policy underwriting; marketing operations; policy administration; premium billing and collection; loss reserve estimation; claim adjudication, settlement and payment; and maintenance of books, accounts, and records. The agreement is continuous for a three-year period following the effective date unless terminated by either party upon not less than 60 days advance written notice.
6. 2002 General Services Agreement - Effective January 1, 2002, a general services agreement was established between Milwaukee Casualty Insurance Co. and Unitrin Direct Insurance Company. The agreement provides that Unitrin Direct will administer all aspects of the direct-marketing private passenger automobile business of Milwaukee Casualty. Unitrin Direct exercises comprehensive authority to administer all aspects of the subject business, including policy underwriting; marketing operations; policy administration; premium billing and collection; loss reserve estimation; claim adjudication, settlement and payment; and maintenance of books, accounts, and records. The agreement is continuous for a three-year period following the effective date unless terminated by either party upon not less than 60 days advance written notice.
7. 2002 Administrative Services Agreement – Effective January 1, 2002, separate administrative services agreements were established between Valley Insurance Company, Trinity Universal Insurance Company, and Milwaukee Insurance Company, Milwaukee Casualty, Milwaukee Safeguard, and Alpha P&C. Under the agreements, VIC is responsible for the field service administration of all aspects of the Milwaukee insurers' policies serviced in the State of Oregon that are not performed by Trinity Universal. Services performed by VIC include regulatory filings, underwriting, settlement and payment of all claims, reporting to Trinity Universal and the Milwaukee insurers, and maintenance of statistical data. The agreement provides that VIC will invoice Trinity Universal and the Milwaukee insurers for the Milwaukee insurers' proportionate share of VIC's expenses incurred in providing the services. Payment for VIC services to the Milwaukee insurers is paid by Trinity Universal.

V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. The company's reinsurance contracts contained proper insolvency provisions.

The company's reinsurance program consists of the following two types of reinsurance transactions: (1) participation as a ceding insurer in external reinsurance treaties in which Trinity Universal is the lead ceding company; and (2) affiliated 100% quota share cession of the company's net retained liability to Trinity Universal Insurance Company.

External Third-Party Ceded Reinsurance

The company participates under various Trinity Universal reinsurance treaties for the majority of customary reinsurance coverages so as to limit risk exposure due to large losses and catastrophic loss occurrence. The group maintains property catastrophe reinsurance that is structured in three layers. The company's catastrophe treaties provide that the company retains \$3,000,000 for each loss occurrence and is afforded 95% coverage of all losses in excess of the company's retention up to \$55,000,000 of loss per loss occurrence. The reinsurers' liability limit for all loss occurrences in the contract period is \$94,000,000. The principal participating reinsurers in the Trinity Universal group reinsurance policies are General Reinsurance Corporation, Swiss Reinsurance America Corporation, and Lloyds of London.

Affiliated Ceded Reinsurance

Effective January 1, 1997, Alpha Property & Casualty Insurance Company established a 100% quota share ceded reinsurance agreement with Trinity Universal. The agreement covers 100% of the net policy obligations of all business written on or after January 1, 1997. Risks ceded by the company to Trinity Universal are net of all external third-party reinsurance cessions.

The 1997 agreement provides that Trinity Universal, on behalf of Alpha P&C and in Alpha P&C's name, shall be responsible for the administration of all aspects of Alpha P&C written policies. Subject to the general supervision of the Alpha P&C board of directors, Trinity Universal provides services including but not limited to handling of all regulatory filings, underwriting, accepting risks and issuing the policies, billing and collecting all premiums, paying all agents and

broker's commissions, adjusting and paying all claims under the policies, reporting to Alpha P&C, compiling statistical data necessary for Alpha P&C to comply with all financial reporting and regulatory reporting requirements, and other services as are required by the reinsurance agreement service schedule.

Amendments to the treaty provide that Trinity Universal may delegate some or all of the administrative services for the Alpha P&C business to other affiliates within the Unitrin, Inc. holding company group. The treaty was amended effective January 1, 2000 to exclude insurance issued, entered into, or assumed by Alpha covering risks on property located in the state of Florida, and was subsequently amended effective July 1, 2001 to negate the 2000 exclusion of business written in Florida. The current agreement now has the terms of the original agreement regarding ceded coverages, and provides for 100% quota share cession of the net liability of Alpha P&C for all business written by the company in all states in which the company writes insurance business.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Alpha Property & Casualty Insurance Company
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	\$ 7,468,101	\$0	\$ 7,468,101
Cash	149,468		149,468
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	2,605,491		2,605,491
Premiums, agents' balances, and installments booked but deferred and not yet due	2,667,167		2,667,167
Federal and foreign income tax recoverable and interest thereon	855,486		855,486
Interest, dividends, and real estate income due and accrued	165,278		165,278
Receivable from parent, subsidiaries, and affiliates	555,893		555,893
Write-ins for other than invested assets			
Prepaid commissions	<u>58,880</u>	<u>58,880</u>	<u> </u>
Total Assets	<u>\$14,525,764</u>	<u>\$58,880</u>	<u>\$14,466,884</u>

Alpha Property & Casualty Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Losses	\$271,577
Loss adjustment expenses	12,344
Other expenses (excluding taxes, licenses, and fees)	34,725
Taxes, licenses, and fees (excluding federal and foreign income taxes)	83,724
Federal and foreign income taxes	1,576
Unearned premiums	3,543,494
Ceded reinsurance premiums payable (net of ceding commissions)	2,605,491
Amounts withheld or retained by company for account of others	31,098
Payable to parent, subsidiaries, and affiliates	<u>849,753</u>
 Total Liabilities	 7,433,782
 Common capital stock	 2,400,000
Gross paid in and contributed surplus	2,100,000
Unassigned funds (surplus)	<u>2,533,102</u>
 Surplus as Regards Policyholders	 <u>7,033,102</u>
 Total Liabilities and Surplus	 <u>\$14,466,884</u>

Alpha Property & Casualty Insurance Company
Summary of Operations
For the Year 2001

Underwriting Income

Premiums earned	\$1,258,017
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Deductions:

Losses incurred	970,949
Loss expenses incurred	170,700
Other underwriting expenses incurred	<u>891,860</u>
Total underwriting deductions	<u>2,033,509</u>

Net underwriting loss	(775,493)
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Investment Income

Net investment income earned	<u>206,247</u>
Net investment gain	206,247

Other Income

Net loss from agents' or premium balances charged off	(48,024)
Finance and service charges not included in premiums	<u>44,610</u>
Total other income	<u>(3,414)</u>

Net loss before dividends to policyholders and before federal and foreign income taxes	(572,659)
Dividends to policyholders	<u>0</u>

Net loss after dividends to policyholders but before federal and foreign income taxes	(572,659)
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Federal and foreign income taxes incurred	<u>98,590</u>
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Net Loss	<u><u>\$ (671,249)</u></u>
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Alpha Property & Casualty Insurance Company
Cash Flow
As of December 31, 2001

Premiums collected net of reinsurance	\$1,739,325	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	1,109,392	
Underwriting expenses paid	<u>802,722</u>	
Cash from underwriting		\$(172,789)
Investment income (net of investment expense)		194,069
Other income (expenses):		
Agents' balances charged off	(48,024)	
Net amount withheld or retained for account of others	7,499	
Write-ins for miscellaneous items:		
Finance and service charges	<u>42,995</u>	
Total other income		2,471
Net cash from operations		\$23,751
Proceeds from investments sold, matured, or repaid:		
Bonds	<u>360,507</u>	
Total investment proceeds		360,507
Cost of investments acquired (long-term only):		
Bonds	<u>1,700,070</u>	
Total investments acquired		<u>1,700,070</u>
Net cash from investments		(1,339,563)
Cash provided from financing and miscellaneous sources:		
Net transfers from affiliates	<u>205,585</u>	
Total		205,585
Cash applied for financing and miscellaneous uses:		
Other applications	<u>58,880</u>	
Total		<u>58,880</u>
Net cash from financing and miscellaneous sources		<u>146,705</u>
Net change in cash and short-term investments		(1,169,108)
Reconciliation		
Cash and short-term investments, December 31, 2000		<u>1,318,575</u>
Cash and short-term investments, December 31, 2001		<u>\$149,468</u>

Alpha Property & Casualty Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2001

Assets	\$14,466,884	
Less liabilities	<u>7,433,782</u>	
Adjusted surplus		\$7,033,102
Annual premium:		
Lines other than accident and health	4,410,427	
Factor	<u>20%</u>	
Compulsory surplus		<u>882,085</u>
Compulsory surplus excess (or deficit)		<u>\$6,151,017</u>
Adjusted surplus (from above)		\$7,033,102
Security surplus:		
(140% of compulsory surplus, factor reduced 1% for each		
\$33 million in premium written in excess of		
\$10 million, with a minimum factor of 110%)	<u>1,234,919</u>	
Security surplus excess (or deficit)		<u>\$5,798,183</u>

Alpha Property & Casualty Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	\$5,973,078	\$6,587,132	\$6,901,680	\$7,170,547	\$7,506,657
Net income	607,335	291,916	255,684	319,357	(671,249)
Net unrealized capital gains or (losses)	(2,297)				
Change in net deferred income tax					232,403
Change in non-admitted assets	18,466	13,182	23,182	16,753	(58,880)
Change in excess of statutory reserves over statement reserves	(9,450)	9,450			
Cumulative effect of changes in accounting principles					24,172
Surplus, end of year	<u>\$6,587,132</u>	<u>\$6,901,680</u>	<u>\$7,170,547</u>	<u>\$7,506,657</u>	<u>\$7,033,102</u>

Alpha Property & Casualty Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2001

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios is included following the table of IRIS ratios.

	Ratio	1997	1998	1999	2000	2001
#1	Gross Premium to Surplus	95%	89%	134%	334%	856%
#2	Net Premium to Surplus	0%	0%	0%	12%	63%
#3	Change in Net Writings	-99% *	0%	0%	999% *	403% *
#4	Surplus Aid to Surplus	0%	0%	0%	0%	0%
#5	Two-Year Overall Operating Ratio	125% *	0%	0%	18%	96%
#6	Investment Yield	3% *	6.1%	5.7%	7%	2.7%*
#7	Change in Surplus	-9%	5%	4%	5%	-1%
#8	Liabilities to Liquid Assets	5%	1%	11%	33%	71%
#9	Agents' Balances to Surplus	3%	0%	1%	3%	37%
#10	One-Year Reserve Devel. to Surplus	0%	0%	0%	2%	-1%
#11	Two-Year Reserve Devel. to Surplus	6%	0%	0%	0%	3%
#12	Estimated Current Reserve Def. To Surplus	-1%	0%	0%	0%	0%

The exceptional results in 1997 for IRIS ratios number 3, change in writings, number 5, two-year overall operating ratio, and number 6, investment yield, were due to the company initiating a 100% ceded quota share treaty with its parent, Trinity Universal Insurance Company, effective January 1, 1997. The 1997 cession of 100% of the company's written insurance liabilities reduced net writings to zero, and caused the two-year operating ratio to increase relative to 1996 due to the 1997 cession of all premiums related revenues and expenses. The 1997

transfer of assets that were related to the insurance risks ceded in 1997 significantly decreased company invested assets relative to 1996 and resulted in a decreased investment yield ratio.

The unusual results in 2000 and 2001 for IRIS ratio number 3, change in writings, were due to the company's entry into and retention of business written in the State of Florida. The 2000 and 2001 retention of risks caused large annual increases in the company's net premiums relative to the three prior years, during which the company's annual net premiums written equaled zero.

Growth of Alpha Property & Casualty Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1997	\$6,865,372	\$278,240	\$6,587,132	\$607,335
1998	6,983,840	82,160	6,901,680	291,916
1999	7,213,169	42,624	7,170,545	255,684
2000	8,292,203	785,547	7,506,655	319,357
2001	14,466,884	7,433,782	7,033,102	(671,249)

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1997	\$6,252,237	\$(4,292,774)	\$0	0.0%	0.0%	0.0%
1998	6,158,417	0	0	0.0%	0.0%	0.0%
1999	9,605,394	0	0	0.0%	0.0%	0.0%
2000	25,072,145	877,597	486,513	179.7%	15.9%	195.6%
2001	60,194,895	4,410,427	1,258,017	94%	113.5%	207.5%

From 1997 through 2000 the company has realized annual net income derived from investment income. Effective January 1, 1997 through December 31, 1999 the company ceded 100% of its net retained gross premiums to its parent, Trinity Universal Insurance Company pursuant to a 100% quota share reinsurance treaty. The quota share treaty was amended effective January 1, 2000 to exclude business written in Florida, and through December 31, 2001 the company retained liability for its direct written Florida business. Effective July 1, 2001, the quota share treaty was amended to again include business in Florida, and effective September 1, 2001 the company again cedes 100% of its written premiums and does not have any net retained liability for insurance risks.

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus as regards policyholders surplus reported by the company as of year-end 2001 and as determined by this examination:

Surplus December 31, 2001, per Annual Statement			\$7,033,101
	Increase	Decrease	
Premium in course of collection	\$	\$2,605,491	
Premium deferred not yet due		2,667,167	
Federal income tax recoverable		244,099	
Affiliated receivables		555,893	
Losses	271,577		
LAE	12,344		
Taxes, licenses and fees	83,724		
Unearned premiums	3,543,494		
Ceded reinsurance payable	2,605,491		
Amounts withheld	<u>7,500</u>		
Net increase or (decrease)	<u>\$6,542,130</u>	<u>\$6,072,560</u>	<u>451,570</u>
Surplus December 31, 2001, per Examination			<u>\$7,484,671</u>

Examination comment and recommendation regarding the above noted balance sheet account adjustments is included in the examination findings section of this report under the caption "Financial Reporting."

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were four specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. **Management and Control**—It is recommended that the company file biographical data on each member of the board with the Commissioner's office in accordance with s. Ins 6.52 (3), Wis. Adm. Code.

Action—Compliance.

2. **Invested Assets - Bonds**—It is recommended that the company review its Schedule D - Part 1 and report the correct par value of bonds, as well as, report the correct CUSIP numbers of securities reported in Schedule D, pursuant to the instructions of the NAIC Annual Statement Instructions-Property and Casualty companies and Purposes & Procedures of the Security Valuation Office of the NAIC.

Action—Compliance.

3. **Invested Assets - Preferred Stock**—It is recommended that the company file Security Acquisitions Requests (SAR's) for all securities that are not designated by the NAIC in the Security Valuation Office data files pursuant to the NAIC's Purposes and Procedures Manual of the NAIC Securities Valuation Office and certify such in the SVO Compliance Certification as required by the NAIC's Annual Statement Instructions-Property and Casualty.

Action—Compliance.

4. **Affiliated Payables/Receivables**— It is recommended that the company perform timely settlement of its affiliated balances in accordance with the settlement terms and provisions established by its intercompany service agreements.

Action—Noncompliance. Further comment is included in the section of this report captioned "Financial Reporting."

Summary of Current Examination Results

Financial Reporting

Examination review identified significant deficiencies in the company's financial reporting practices and procedures. The company's deficient administration of financial information and financial reporting gave rise to material errors that overstated total assets by \$6,072,560 (72%), overstated total liabilities by \$6,524,130 (7,172%), and understated surplus by \$451,570 (6%) in the company's 2001 statutory annual statements. Examination adjustment of account balances is detailed in the Financial Data section of this report captioned "Reconciliation of Surplus per Examination."

Most of the incorrectly reported balance sheet accounts pertain to accounting for business that was written in the state of Florida and retained by Alpha P&C for its own account through August 2001. The Florida business is produced on behalf of Alpha P&C by its affiliate, Unitrin Direct, which also performs the day to day administration and accounting for this business. Effective September 2001, all of the company's new and existing business written in Florida was ceded to Trinity Universal under Alpha P&C's 100% quota share reinsurance treaty with Trinity Universal. Beginning in September 2001, Alpha P&C properly accounted for the ongoing business written in Florida by reflecting 100% of the business as ceded to Trinity Universal and by eliminating the related assets and liabilities of this business from its balance sheet accounts. The asset and liability balances related to the Florida business existent as of August 2001 also should have been transferred to Trinity Universal in September 2001 upon the inclusion of the Florida business in the company's 100% ceded reinsurance contract. However, the August 2001 asset and liability balances were mistakenly carried forward in the ledger accounts of the company, were incorrectly reported as assets and liabilities in the 2001 annual statement, and remained in the company's ledger accounts through June of 2002.

Alpha P&C does not have a system of centralized ledger accounts or account data with which to record and report financial data for the company's business transactions. The company prepared its 2001 annual statement by compiling an aggregate Alpha P&C financial report from 3 separate annual statement reports prepared by the three affiliates who produce

Alpha P&C business. Each of the three separate statements from the affiliates reported 2001 financial balances for the portion of Alpha P&C business administered by the respective affiliates. Data in the affiliate statements were summed and were reported as the balances in the Alpha P&C financial reports.

The company's primary financial data originates from the multiple affiliates who produce and administer Alpha P&C's business. Each of the affiliates has independent accounting and financial reporting operations, and there is not a common chart of accounts, general ledger, or trial balance system among the affiliates who account for their respective portions of Alpha P&C business administration. The producer affiliates do not use common computer software systems that would facilitate centralized administration of Alpha P&C financial reporting. Alpha P&C has not instituted adequate practices and procedures to accumulate, review, and oversee the financial accounting and financial reporting functions of the aggregate Alpha P&C legal entity, and has not established adequate centralized employee administrative responsibility for maintaining its accounts and records or for ensuring the accuracy of financial reports.

It is recommended that the company establish centralized general ledger and data information systems to ensure that the business of Alpha P&C is properly reflected in the company's accounts and records. It is further recommended that the company establish centralized practices and procedures, sufficient assignment of office personnel, and appropriate designation and assignment of administrative responsibility to enable the company to maintain accurate accounts and records and to ensure that the account balances and financial transactions of the company are properly reported in the company's statutory financial reports.

As described above, the company failed to timely account for and make settlement of its affiliated balances, having performed reconciliation and settlement of September 2002 balances in June 2003. The prior examination also determined that company settlement of affiliated balances was deficient, and recommended that the company perform timely settlement of affiliated balances. It is again recommended that the company perform timely review and reconciliation of general ledger accounts, and that the company perform timely settlement of

intercompany balances and accounts, in accordance with the settlement terms and provisions established by its intercompany reinsurance and service agreements.

Custody of Invested Assets

The company's invested assets are held in the custody of a trust bank under an appropriate custodial agreement. However, the safekeeping agreement does not have adequate provisions with regard to the fiduciary responsibility of the custodian. The agreement provides that the custodian's liability for loss to the company is limited to loss arising out of custodian negligence or willful misconduct.

The safekeeping agreement is inadequate in that it fails to provide explicit provisions regarding the duties of the custodian. An insurer's custodian agreements should specify the circumstances of loss and the indemnification requirements that apply to the custodian's obligation to indemnify the insurer for loss of assets held in the safekeeping account. It is recommended that the company's custodial agreements be amended to expressly provide for the fiduciary obligations of the custodian and the custodian's specific obligations to indemnify the company, in conformity with the custodial agreement guidance provided by the NAIC Examiner's Handbook.

Annual Statement Schedule D Reporting

Review of the company's reported annual statement Schedule D noted that some of the securities listed in Schedule D had matured or had been sold or otherwise disposed of, and were no longer reported in the account statements of the company's custodian. It is recommended that the preparation of Schedule D include deletion of securities which have matured, sold, or otherwise disposed of, so as to ensure correct identification of the securities that are owned by the company and to eliminate securities that are no longer owned by the company, in compliance with NAIC Annual Statement Instructions—Property and Casualty.

Affiliated Contracts

Examination review of the contract agreement between Alpha P&C and Charter Agency determined that the agreement provides that an annual CPA audit of Charter Agency will be performed on behalf of the interests of Alpha P&C. The practice of the companies is to not perform an annual CPA audit of Charter Agency. Best business practices for an insurer include the maintenance of formal agreements with affiliates with which the insurer has transaction relationships, the affiliated agreements properly reflecting the actual rights and responsibilities between contracting parties. It is recommended that the company either obtain an annual CPA audit of Charter Agency or otherwise amend its agreement with Charter Agency, and that the company maintain each of its affiliated agreements so as to accurately reflect the operation of the agreements and the rights and responsibilities of the parties to the agreements.

VIII. CONCLUSION

Alpha Property & Casualty Insurance Company is a Wisconsin domiciled stock property and casualty insurance company. The company was originally organized in 1979, and was purchased December 31, 1992 by Milwaukee Insurance Group, Inc., then a holding company subsidiary of Milwaukee Insurance Company. Effective October 2, 1995, Trinity Universal Insurance Company, a subsidiary of Unitrin, Inc., purchased all of the capital stock of Milwaukee Insurance Group, Inc. and thereby acquired ownership and control of Alpha Property & Casualty Insurance Company. In 2001 MIG was dissolved and Alpha P&C became a directly held wholly owned subsidiary of Trinity Universal.

Alpha P&C does not have any employees, and all operations of the company are performed by Trinity Universal and other affiliates within the Unitrin, Inc. holding company pursuant to intercompany services and reinsurance agreements. The company is licensed in 22 states, and writes sub-standard risk automobile, motorcycle, and related insurance lines. The company cedes 100% of its net insurance risks to Trinity Universal, and does not retain any policy-related risks for its own account.

The current examination found that the company had significant deficiencies in its financial reporting function due to the absence of a centralized system of accounts and records and inadequate centralized administrative organization. Current examination findings of exception are summarized in section IX of this report. The current examination determined that the company is in compliance with the recommendations of the prior examination except for the prior recommendation regarding timely settlement of affiliated balances.

The current examination adjusted numerous balance sheet account balances that were incorrectly reported by the company in its year-end 2001 statutory financial statements. The examination adjustments decreased reported assets by \$6,072,560, reduced reported liabilities by \$6,524,130, and increased reported surplus by \$451,570. The examination determined that, as of December 31, 2001, the company had admitted assets of \$8,394,324, total liabilities of \$909,652, and policyholders' surplus of \$7,484,672.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 28 - Financial Reporting—It is recommended that the company establish centralized general ledger and data information systems to ensure that the business of Alpha P&C is properly reflected in the company's accounts and records. It is further recommended that the company establish centralized practices and procedures, sufficient assignment of office personnel, and appropriate designation and assignment of administrative responsibility to enable the company to maintain accurate accounts and records and to ensure that the account balances and financial transactions of the company are properly reported in the company's statutory financial reports.
2. Page 28 - Financial Reporting—It is again recommended that the company perform timely review and reconciliation of general ledger accounts, and that the company perform timely settlement of intercompany balances and accounts, in accordance with the settlement terms and provisions established by its intercompany reinsurance and service agreements.
3. Page 29 - Custody of Invested Assets—It is recommended that the company's custodial agreements be amended to expressly provide for the fiduciary obligations of the custodian and the custodian's specific obligations to indemnify the company, in conformity with the custodial agreement guidance provided by the NAIC Examiner's Handbook.
4. Page 29 - Annual Statement Schedule D Reporting—It is recommended that the preparation of Schedule D include deletion of securities which have matured, sold, or otherwise disposed of, so as to ensure correct identification of the securities that are owned by the company and to eliminate securities that are no longer owned by the company, in compliance with NAIC Annual Statement Instructions—Property and Casualty.
5. Page 30 - Affiliated Contracts—It is recommended that the company either obtain an annual CPA audit of Charter Agency or otherwise amend its agreement with Charter Agency, and that the company maintain each of its affiliated agreements so as to accurately reflect the operation of the agreements and the rights and responsibilities of the parties to the agreements.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Richard Harlow Anderson	Insurance Examiner
Tom Janke	Insurance Examiner
Cruz J. Flores	Insurance Examiner

Respectfully submitted,

Thomas E. Rust
Examiner-in-Charge